BBVA Research

U.S.

Fed Watch

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Economic Analysis

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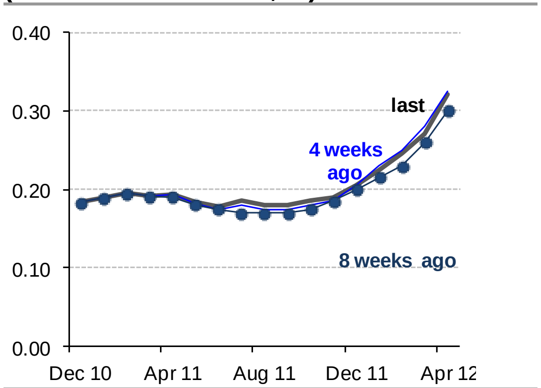
FOMC Minutes: December 14 Meeting

Fed sees no reason at present to change policy stance

- **Staff expects higher output, but forecast for 2011-12 not appreciably changed**
- **FOMC members see housing sector, Europe and state and municipalities as risks**

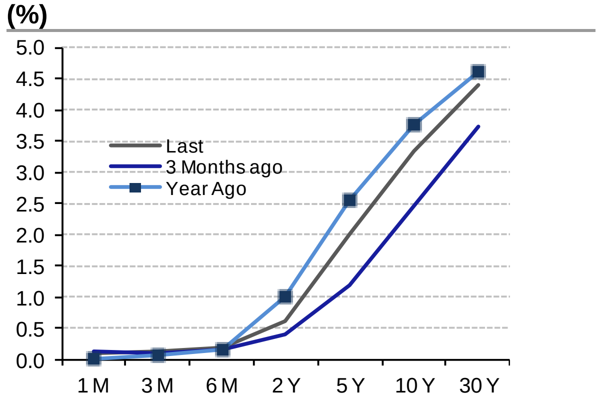
Minutes of the last FOMC meeting held on December 14, 2010 include no surprises. The minutes revealed that the extension of the US dollar liquidity swap facilities with foreign central banks announced on December 21 was decided during the meeting. Federal Reserve Staff members believe that the economy grew at a moderate pace alongside increased consumer spending, higher exports and a continued upturn in business spending on equipment and software. However, the unemployment rate remains elevated and construction activity is still weak. During the inter-meeting period, long-term interest rates rose appreciably, which FOMC members attribute to five factors: 1) market expectations which overestimated the size of the November LSAP program, 2) additional fiscal stimulus from tax cuts, 3) an improved economic outlook, 4) expected increases in long-term deficits, and 5) year-end positioning by mutual funds and other investment companies. FOMC members viewed three major risks to the economic situation. First, fiscal tremors in Europe may spill over to US financial institutions and consumer confidence. Second, even lower housing activity and a second prolonged decline in home prices would adversely affect the US economy. Lastly, the spending and revenue positions of state and municipal governments may also negatively impact consumer spending and business activity in the form of higher taxes. On the inflation front, FOMC members expect that the inflation rate will continue to be below the level consistent with price stability and maximum employment, although the risk of deflation has receded somewhat. However, some FOMC members urged all participants to continue planning for an exit from extraordinary monetary policies. Given today's release of the minutes, we expect that the Fed will continue its current LSAP program until its scheduled completion at the end of 11Q2, although the Fed will continue to monitor economic conditions. With growth still at a very moderate pace, unemployment at high levels, and FOMC members' still seeing no risk of inflation, these conditions imply no need for change in policy. We expect that over the course of the following meetings the Fed will begin to consider how to craft a communication strategy for either the end or the continuation of the LSAP program.

Chart 1
Fed Funds Expectations (Future Contract End, %)



Source: Bloomberg & BBVA Research

Chart 2
Treasuries Yield Curve (%)



Source: Bloomberg & BBVA Research

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